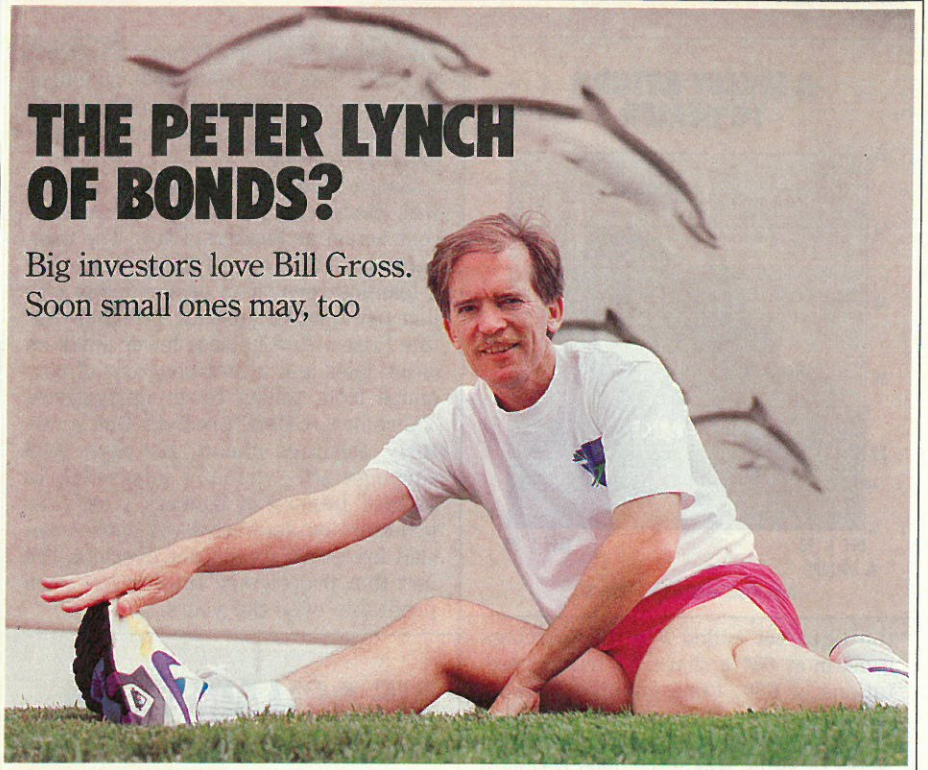

THE PETER LYNCH OF BONDS?

Big investors love Bill Gross. Soon small ones may, too

GROSS: THE MARATHON RUNNER HAS A 20-YEAR ENDURANCE RECORD IN THE BOND MARKET

Rattled by this year's volatile bond market? Relax, says William H. Gross, one of the country's leading bond investors and the managing director of Pacific Investment Management Co. (PIMCO). Gross likens the bond market that's emerging to a placid creek where he played as a child in Middletown, Ohio. The people along its banks, says Gross, "won't need levees or sandbags." And, he adds, this creek "won't shatter lives."

Not everybody thinks there's a kinder, gentler bond market ahead. But $55 billion—mainly pension money from blue-chip corporations, state and local governments, and even a few foreign central banks—believes he's right. And for good reason. Gross, 50, a soft-spoken marathon runner, is one of the founders and the mastermind of an investment firm that has speed and endurance. Since 1974, PIMCO has earned an annual average return of 11.1%, vs. 9.6% for the Lehman Brothers Government/Corporate Bond Index. In the tortured first quarter of 1994, PIMCO was down 2.8%, but the index fared worse, off 3.1%.

MORE VISIBLE. Winning by a percentage point is no big deal in stocks, but it makes for heroes in bonds. That's why Gross is known as the Peter Lynch of bonds. "It's hard to add value to a bond portfolio without increasing volatility," says Kathleen A. Crowley, vice-president of Stratford Advisory Group Inc., a pension consulting firm. "But Bill Gross and his team manage to do it."

Gross is little known to individual investors, since it takes a cool $75 million to open a separately managed account with PIMCO. That's steep even for many pension funds, which can opt for PIMCO's mutual funds, where the minimum is just $500,000. PIMCO lets individuals with $1,000 into the funds if they come via one of four discount brokerage firms that take care of record-keeping PIMCO doesn't do. Gross also manages Harbor Bond Fund for Harbor Capital Advisors. That fund earned a top rating for five-year risk-adjusted performance in the 1994 BUSINESS WEEK Mutual Fund Scoreboard. But with only $167 million, Harbor Bond is a relatively undiscovered property.

Now, Gross is becoming more visible. In the next few months, PIMCO and four smaller units of parent Pacific Mutual Life Insurance Co. are expected to merge with Thomson Advisory Group LP, a master limited partnership that trades on the Big Board, to form PIMCO Advisors LP. Thomson, which is based in Stamford, Conn., with $11 billion in managed assets, is mainly an equity manager, while PIMCO, which will remain in Newport Beach, Calif., is mostly bonds. Gross says that he hopes to reach out to individual investors through Thomson's mutual-fund arm.

The merger will, for the first time, allow the public to invest in the bond whiz himself. In the merger, units in the Thomson partnership, which now sell at 35¼ and pay a $2.40-a-year distribution, will convert to PIMCO Class A units with a $3.75 payout. Considering the higher payout, the PIMCO units could jump 30% if the deal is completed. The combined firm should have annual revenues of about $250 million.

Star stock-pickers such as Peter Lynch excel by zeroing in on a company's business and ignoring the economy and interest rates. But macroeconomics drives the bond market, so Gross's investment process starts with a two- to three-year economic outlook, which he and his investment staff of 40 thrash out annually in week-long sessions. Gross recognizes that the stronger U. S. economy is pushing up interest rates, but he believes disinflationary forces—such as corporate downsizing, high debt, and cheap labor—will keep inflation in check. Long-term rates, he figures, will fluctuate between 6% and 8%.

Unlike some bond managers, Gross never makes big bets on the direction of interest rates. Instead, he makes many small bets on many sectors of the bond market when the odds are in his favor. That's a skill he honed as a young man, when he parlayed $200 into $10,000 in several months playing blackjack in Las Vegas. PIMCO was early to incorporate mortgage securities, bond futures, and non-U. S. bonds into its portfolios and reaped extra returns because of it.

OPPORTUNITY KNOCKED. Now, anticipating more stable rates, Gross is emphasizing yield over liquidity, boosting returns by buying illiquid private placements. And, he says, when rates are unlikely to plunge, callable bonds—which have higher yields than noncallables—are smart plays, too. He's also opportunistic: In the wake of the global bond rout, he scooped up $5 billion in European bonds.

One reason for PIMCO's success was Gross's early embrace of high-tech bond-picking techniques. But competitors are catching up. Still, "computers and statistics carry you just so far," says consultant James R. Hamilton of Hamilton & Co., who first brought a client to PIMCO in 1978. "Then, you have to make a judgment." As long as PIMCO has Bill Gross, it should have an edge.

By Jeffrey M. Laderman in New York

BEATING THE BOND MARKET

ANNUAL RETURN	PIMCO TOTAL RETURN COMPOSITE	LEHMAN BROS. GOVT./CORP. BOND INDEX
1984	14.0%	15.0%
1985	23.8	21.3
1986	18.5	15.6
1987	4.1	2.3
1988	9.5	7.6
1989	14.5	14.2
1990	8.2	8.3
1991	18.1	16.1
1992	9.0	7.6
1993	12.2	11.0
1994 (1Q)	−2.8	−3.1

DATA: PACIFIC INVESTMENT MANAGEMENT CO.

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